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JAMAICA'S FOREIGN FINANCIAL SITUATION: TOUCH AND GO

Despite a narrowing of its foreign financial gap* this year, Jamaica faces serious payments difficulties that are only now beginning to ease. The improvement has followed the securing of an IMF standby credit in mid-July, conditioned on a further tightening of an already harsh austerity program. The IMF commitment has paved the way for the left-leaning government of Prime Minister Michael Manley to obtain additional foreign funds. Kingston has succeeded in obtaining and/or is negotiating a patchwork of financing that probably will cover the financial gap and meet essential short-term foreign obligations this year.

Domestic political and economic pressures could still upset this progress. The new austerity, which comes on top of import cuts and other restrictive measures slapped on in the past two years, could cut real GNP another 4 percent in 1977 and further boost the already high inflation and unemployment rates. The result almost

*This article is the eighth in a series on the foreign financial gap faced by individual LDCs. In these articles, *financial gap* is defined as the current account deficit plus amortization of medium and long-term debt; shifts in short-term capital are not included. Previous articles have covered [redacted] the Philippines, South Korea, Argentina, Brazil, Taiwan, and Peru. 25X6

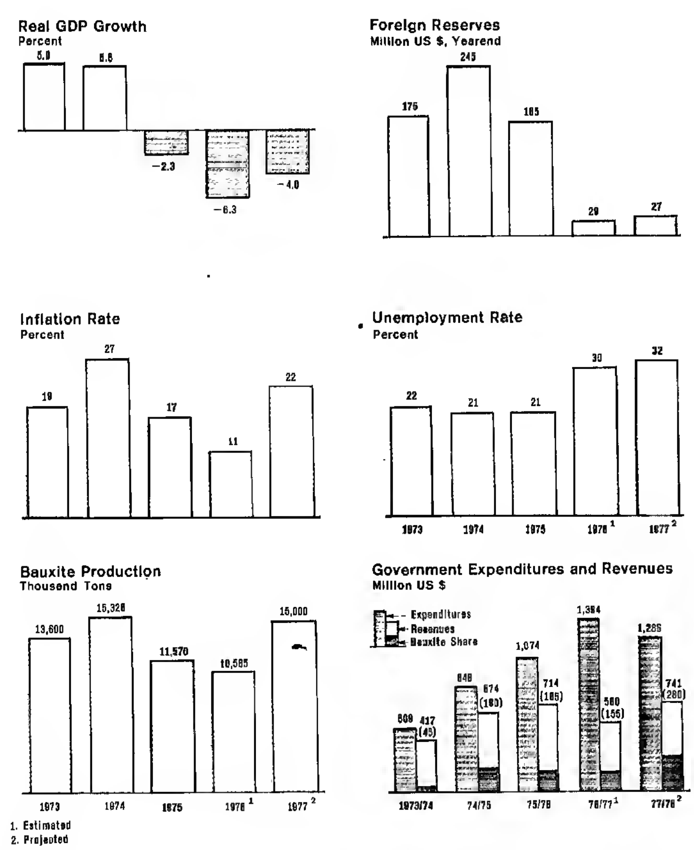
certainly will be further loss of popularity for Manley, whose own supporters have begun to criticize his handling of the economy. In these circumstances, Manley may be strongly tempted to take advantage of the greater availability of foreign financing to increase imports and otherwise to relax austerity measures–a step that would jeopardize the IMF agreement and could put Jamaica back on square one.

Good Times Followed by Slump

Spurred by substantial direct foreign investment in bauxite and tourism, Jamaica enjoyed steady economic growth for the decade before Manley's election in 1972. The economy then began to slip because of the deterioration in investor confidence, which was later intensified by Manley's accelerated leftward drift. Investor fears were justified in 1974 when Manley, prompted by higher oil prices, imposed a 600-percent increase in taxes on bauxite (produced mostly by US aluminum companies) and demanded a small equity share in their Jamaican operations. Jamaica is the source of 37 percent of US bauxite/alumina supplies.

Jamaica initially benefited from the $145 million tax hike. Higher bauxite returns–along with record sugar prices–contributed to a near doubling of export earnings and partly financed a jump in public works expenditures. During 1975-76, however, Jamaica's foreign financial gap trebled to a record $351 million. Weak world demand had reduced bauxite shipments; tourism earnings had been hit by violent crime; and a drop in world prices had cut sugar export earnings by nearly two-thirds. Kingston was unable to cover the gap because capital flight and the loss of direct investment partly offset increased borrowing abroad. Although the Manley government dipped

Jamaica: Economic Indicators



heavily into the short-term money market, it still had to draw against foreign reserves; it further weakened its credit rating by delays in servicing private debts.

To limit inflationary pressures resulting from a spurt in government spending, Kingston in 1975 greatly increased personal income and property taxes and instituted stringent controls on private credit. Austerity measures were intensified last year through the imposition of import restrictions and foreign exchange controls to contain the financial gap. The result was a 6-percent decline in real GNP following the 2-percent drop in 1975; unemployment climbed to about 30 percent of the labor force. Costly strikes, rising violent crime, and increasing leftist influence in the government contributed further to the malaise.

Tightened Payments Bind in 1977

The foreign financial gap has been narrowing in 1977 as a result of a substantial current account improvement. Even so, Jamaica's inability to secure sufficient financing to cover the gap and to meet heavy amortization obligations on past short-term borrowing precipitated a payments crisis by mid-year. Export earnings will likely increase about $126 million (19 percent) in 1977, mainly because recovery of the world aluminum industry will boost demand for Jamaica's bauxite and alumina. Strict foreign exchange controls on private transfers and reduced imports will allow a substantial improvement in the services deficit despite higher interest payments and a probable further decline in tourism. Additional austerity measures imposed in January should slash imports 11 percent below 1976, to $718 million ($825 million on a c.i.f. basis). These measures included strict foreign exchange controls, direct import curbs, increased personal income taxes, and a temporary wage/price freeze.

Reduced capital inflows severely strained Jamaica's ability to cover the $108 million financial gap and to meet net short-term debt service obligations of $250 million. The country faced a 50-percent cut in medium- and long-term capital receipts, to $121 million in 1977, largely because its extremely weak creditworthiness had severely limited new commercial borrowing. Most of the credit promised at that time was from official sources, including $30 million from the US Government this year. Direct investment inflows remained nil. As matters stood before the IMF agreement, Jamaica still had to find as much as $237 million to cover this year's payments needs. Gross foreign exchange holdings were down to about $20 million—less than two weeks' import cover—and provided little cushion.

The IMF Agreement and Financial Impact

In trying to cope with the payments difficulties, Manley followed the advice of political moderates and accepted a $75 million loan from the IMF in mid-July—a move he had earlier scorned. About $35 million of the loan is scheduled to be

disbursed this year. The IMF loan is tied to additional belt-tightening, including an immediate cut in government spending by 8 percent and a more austere wage policy. The IMF dropped demands for an immediate unification of the present dual foreign exchange rates. Instead, Jamaica's compliance with IMF performance criteria will be reviewed in the coming months to decide if the coverage of the recent 38-percent devaluation for tourist and some commercial transactions needs to be extended to curb imports. At the same time, the IMF has eased Jamaica's financial squeeze by postponing repayments due this year on $27 million in compensatory financing and oil facility loans. The IMF also has allowed Jamaica to delay repayment of $67 million in private debts at least until next year without jeopardizing the standby agreement.

The IMF agreement has paved the way for a patchwork of additional foreign financing that we believe probably will cover this year's payments needs if imports are limited to the present target.

- Jamaica has reached preliminary agreement with the aluminum companies for immediate prepayment of at least $40 million in first quarter 1978 bauxite tax liabilities as part of an arrangement covering the next two years.

- Canada is considering the provision of an additional $20 million in commodity grants, most of which will be available in 1977.

- Ottawa also is considering the conversion of $25 million in short-term credits to longer term loans.

- Manley probably can count on as much as $20 million in additional loans from Venezuela.

- Trinidad has offered $45 million in export financing, although only part can be drawn in 1977.

- The Netherlands has pledged loans of $10 million.

- Some additional financing from other official sources such as West Germany may still be worked out.

We expect that this financing will cover Jamaica's financial gap in 1977 as follows:

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	Before IMF Loan	After IMF Loan	
Financial gap	-$108 million	-$96 million	($12 million in Canadian grants)
Medium- and long-term receipts	$121 million	$159 million	($38 million in official loans)
Net short term obligations	-$250 million	-$56 million	($27 million in debt relief and $35 million in new loans from the IMF, $67 million in prospective repayment delays on private loans, $25 million in Canadian debt roll-overs, and $40 million in bauxite tax prepayments)
Deficit or surplus	**-$237 million**	**$7 million**	

Domestic Repercussions

Tightened austerity is having a serious impact on the Jamaican economy this year. The import reduction now projected probably would cut real GNP another 4 percent, to roughly 88 percent of the 1974 level. Manley will likely suffer a further erosion in public support as the unemployment rate is pushed above 30 percent of the labor force, inflation accelerates, and basic goods–including drought-afflicted domestic food stocks–remain in short supply. Jamaican businessmen are protesting that inventories are being exhausted under the current import ceiling, resulting in the closure of retail and manufacturing operations and in black markets for some import items. Moreover, pressures from militant unions for wage increases are mounting in the wake of a strike in June at Jamaica's only oil refinery. In an unprecedented action, the National Workers Union–the trade union based of Manley's party--has begun to criticize the government for its handling of the economy.

In these circumstances, Manley will be strongly tempted to take advantage of the recent improvement in the financial outlook by relaxing import restrictions, thus risking violation of IMF guidelines. Should imports be increased substantially beyond the present target level, they must be matched by a corresponding rise in foreign financing if IMF conditions are to be honored. Since sufficient new financing seems unlikely at this point, a loosening in import restrictions could trigger IMF demands for a full devaluation and/or deeper cuts in major public works programs at

Jamaica: Foreign Financial Gap

	1973	1974	1975	1976[1]	1977[2]
	Million US $				
Exports, f.o.b.	393	754	808	672	798
Imports, f.o.b.	-570	-811	-970	-808	-718
Net services and transfers	-71	-35	-91	-166	-101
Current account balance	**-248**	**-92**	**-253**	**-302**	**-21**
Debt amortization[3]	-17	-23	-32	-49	-75
Financial gap	**-265**	**-115**	**-285**	**-351**	**-96**
Medium- and long-term capital inflows	223	249	206	238	159
Official borrowing	54	122	153	134	149
Direct investment	75	23	0	0	0
Other private inflows	94	104	53	104	10
Net short-term capital and errors and ommissions	12	-64	-1	-32	-56
Change in reserves	**-30**	**70**	**-80**	**-145**	**7**[4]
External public debt yearend	306	474	632	649	611
	Percent				
Debt service ratio (public medium- and long-term)	7	7	9	14	15

[1] Provisional.
[2] Projected.
[3] Public and publicly guaranteed medium- and long-term debt.
[4] Based on financing now contracted or being negotiated, including small disbursements on Trinidad's loan and prepayment of the first quarter 1978 bauxite levy.

the initial performance review in October. Failure to comply could jeopardize the standby agreement and, in turn, the financial patchwork so carefully being worked out.

Outlook

Even if Jamaica weathers the present crisis, the economy faces a bleak outlook over the next few years. Although continuing recovery of the world aluminum industry should allow earnings from bauxite/alumina to increase, imports will have to be kept under tight control at the cost of continued sluggish economic performance. Poor prospects for other major exports and tourism as well as higher debt service payments will prolong the financial gap. Substantial new foreign financing will be needed to cover the gap and permit Jamaica to resume servicing private debts now in arrears.

Ability to attract new capital will remain limited. Manley almost certainly will continue to rely on Western industrial nations as the best source of funds. At the same time, Kingston probably will continue to probe for closer ties with Cuba and the USSR, despite poor prospects for large-scale financial assistance from these sources.

Manley's hope that recent contract settlements with the aluminum companies will lead to renewed investment is ill-founded; the unsettled political situation almost certainly will keep the investment climate poor. [redacted] 25X1X The companies also have balked at Jamaica's request that they resume investment as a condition for including bauxite transactions under the devaluation. Unless Kingston over the next few years can sustain foreign borrowing far beyond the meager levels warranted by its credit rating, pressures for a new bauxite tax hike will mount. The alternative could be increasing violence, strikes, and emigration of Jamaica's middle
25X1A class. (Confidential)

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WORLD TIN AGREEMENT: A MODEL OF INEFFECTIVENESS

Tin prices are expected to remain well above the ceiling recently established under the International Tin Agreement and could set a new high later this year because of lagging production and depleted buffer stocks. The inability of the International Tin Council (ITC) to adjust supplies and to arrest spiraling prices highlights the ineffectiveness of the agreement.

Prices Push Upward

Unlike most industrial commodity prices, which have weakened in the face of sluggish demand and large inventories, tin prices have continued on an upward path in 1977. From 1 January to 8 March, the price on the London Metal Exchange

(LME) jumped 22 percent to a record $4.99 a pound. A leading factor in the runup was the January announcement that the Tin Council's buffer stock holdings had been exhausted.

Subsequent rumors that the US administration might support a bill to authorize the sale this year of 30,500 tons from US stockpiles temporarily weakened prices; US disposals last year amounted to 3,600 tons out of an authorization of 6,000 tons. By the end of March, the LME price had fallen to about $4.00 a pound. The weakness proved short lived as the LME price rebounded to its earlier record high of $4.99 by the end of July. The Penang price, which governs ITC buffer stock adjustments, simultaneously reached $4.84 per pound, 30 cents above the ceiling just set by the ITC.

Supply Prospects Spur Prices

A poor supply outlook is the key factor underpinning high prices this year. We estimate the 1977 tin supply shortfall at about 26,000 tons, compared with the 23,000-ton deficit in 1976. Although demand for tin is expected to grow only 3 percent this year, production is likely to rise even more slowly.

Unlike 1976—when the deficit was offset by the sale of some 20,000 tons from the ITC buffer stock and the 3,600 tons from US stockpiles—no large stocks are so far available to cover the 1977 shortage. ITC buffer stocks are exhausted, and the US stockpile is currently authorized to sell only about 2,000 tons from its tin stocks in 1977.

The lag in tin production results not from a lack of smelter capacity but rather from difficulties in expanding mine output. World tin smelters are currently operating between 65 percent and 70 percent of capacity, leaving at least 60,000 tons of capacity idle.

Government taxing and licensing practices in major producing countries have blunted new investment in mining and have discouraged many small mining firms from reentering the market, despite higher prices. In Malaysia, the world's largest producer, the number of small firms declined one-fourth between 1974 and mid-1977. Licensing restrictions by individual Malaysian states have retarded the number of new large-scale dredging operations. Levies on dredge operations have tripled since 1972 and now exceed 40 percent of production costs.

In Bolivia, the highest cost tin producer, the burden of taxes and royalties is an even greater deterrent to investment. Including taxes and royalties, Bolivian production costs in most cases exceed the floor price set by the ITC.

ITC Requests Assistance

An ITC official recently took the unusual step of requesting the release of large quantities of US stockpiled tin directly to the market. Even producer members of the Council probably would welcome substantial direct stockpile releases this year to assure the continued participation of consumer members in the agreement. They view the prospective US pledge of 5,000 tons to the ITC buffer stock as insufficient by itself to dampen prices.

Other actions taken by the ITC are unlikely to have an impact over the short run. These include the recent admonitions aimed at producing countries to spur investment in tin mining by revising their burdensome taxes. Both Bolivia and Malaysia have indicated intentions to move in this direction, but, even if they adopt such actions, it would be at least early 1978 before output was affected.

Implications for Other Commodity Agreements

The demonstrated inability of the Tin Agreement to protect the interests of consumer members could have an adverse effect on negotiations underway on other international commodity arrangements. Sometimes cited as a model commodity arrangement, the Tin Agreement has helped to shape the format of discussions for commodity agreements such as rubber and copper. The tin format has already been adopted for the International Cocoa Agreement.

Consultations on the UNCTAD-sponsored commodity agreement in rubber will be resumed in October, and consuming countries already are voicing concern about the ability of the proposed rubber buffer stock to control prices. Other agreements in the offing are likely to face similar questioning by consumers. (Unclassified)

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COCOA PRICES: EASING FROM LAST MONTH'S PEAK

World cocoa prices appear to be edging off from last month's record high levels. Consumption cutbacks, already under way as users find substitutes for high-priced cocoa, will exert gradually increasing downward pressure on price. However, low stocks and prospects for a mediocre 1977/78 crop should keep prices relatively strong over the next 12 months. Cocoa prices will continue to far exceed the ceiling negotiated under the International Cocoa Agreement.

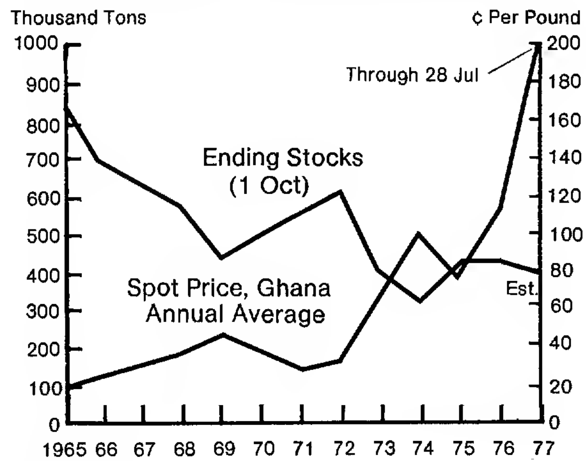
Spot prices for Bahia cocoa reached a record $2.48 per pound on 18 July—an increase of 25 percent since late June and more than double the level of July 1976.

Although prices have subsequently eased, they are still four times as high as the 55-cent ceiling price of the currently meaningless International Cocoa Agreement.

Consumption Off

Consumption of cocoa has traditionally been measured in terms of cocoa grind and net imports. Cocoa is actually consumed in the form of many diverse products manufactured from the three bean grind derivatives—cocoa powder, cocoa butter, and cocoa liquor. Powdered cocoa accounts for the largest percentage of consumption since its uses include confectionary items, candies, puddings, and beverage flavorings. Due to the nature of the end products of cocoa manufacture, sugar is a key complementary ingredient.

Cocoa: World Stocks and Prices



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Statistics of cocoa bean grind indicate a substantial reduction in worldwide consumption during second quarter 1977. The largest cocoa bean importer, the

Importer Cocoa Grindings

Thousand Tons

	World Total	United States	West Germany	USSR	Nether-lands	United Kingdom
1970	1,357	266	126	102	115	82
1971	1,438	279	133	110	121	84
1972	1,566	289	139	132	124	98
1973	1,557	278	152	134	123	107
1974	1,477	230	138	143	115	93
1975	1,445	208	139	150	119	73
1976	1,503	230	137	126	127	83
1977[1]	1,396	205	134	85	120	79

[1] International Cocoa Organization forecast.

United States, showed a 15-percent decline over the comparable 1976 period. Grindings were also down by more than 5 percent in the United Kingdom, France, and West Germany, while grindings in the Netherlands were unchanged. Recent data on Soviet grindings are unavailable, but USSR imports in 1976 were 16 percent below 1975. The Soviet representative to the International Cocoa Organization forecast a 33-percent reduction in grindings for 1977.

Retail prices for cocoa products generally lag six months behind bean prices due to the additional manufacturing required. Current retail prices, which reflect bean costs of about $1.80 per pound, have also been dampened by the low price for sugar. Still, a recent European cocoa manufacturing industry study shows a 25-percent decline in cocoa products consumption. This decline will gradually be reflected in reduced cocoa grindings and a lower demand for cocoa beans.

Supplies Continue Tight

World cocoa production for the 1976/77 season (October through September) is estimated at 1.37 million tons—a decline of 9 percent from last season's crop. Production in Ghana and Nigeria, traditionally the world's largest producers, is off 18 percent. Brazilian production is down 8 percent, a result of cocoa pod rot, while production has increased only slightly in the Ivory Coast. Current bean stocks are now equal to three months' consumption, compared with a normal four to five months' supply and the record low of 2.6 months' supply hit in 1974.

Although weather problems have affected the crops in Ghana and Nigeria, the decline is mainly attributable to the poor incentives provided. Very little effort has been made to increase yields and acreage or combat disease in these countries, largely because the price received by producers is far below the world price. When the world price was $1.85 per pound in early 1977, prices received by producers were as follows: Ghana, $0.39; Nigeria, $0.43; Brazil, $0.85; and the Ivory Coast, $1.00.

Beyond these basic supply factors, temporary supply difficulties contributed to last month's price spurt. Available cocoa supplies for importers have been reduced due to shipment problems from the three African producers. Rumors of poor crop prospects in coming months due to drought in Africa and pod rot in Brazil have accentuated the record price climb.

We estimate that world production for the 1977/78 season will show no major improvement: (a) drought in Ghana threatens to add further to the gradual decline in that country's production; (b) production in Nigeria is not likely to increase even with favorable weather conditions; and (c) production in Brazil and the Ivory Coast should improve considerably with favorable weather. World production should range between 1.35 million and 1.44 million tons.

Cocoa Production

Thousand Tons

	World Total	Ghana	Brazil	Ivory Coast	Nigeria
1969/70	1,435	416	201	181	223
1970/71	1,498	392	182	180	308
1971/72	1,582	464	167	226	255
1972/73	1,398	418	162	181	241
1973/74	1,446	350	246	209	215
1974/75	1,546	377	273	242	214
1975/76	1,510	397	258	231	216
1976/77[1]	1,370	325	237	235	175
1977/78[2]	1,400	310	250	240	175

[1] Preliminary.
[2] Forecast.

Price Outlook

We believe prices have already peaked unless Africa's main crop continues to deteriorate this fall. Consumption has dropped and will decline further. Although cocoa prices should continue at relatively high levels for the next 12 to 18 months, the decline in consumption ultimately will become the dominant price-determining factor. The escalation of cocoa prices has encouraged use of substitute products, many of which will hold their larger market shares after the price of cocoa declines.

Implications for the Cocoa Agreement

The International Cocoa Agreement of 1976, like many existing agricultural commodity agreements, has resulted in little more than an increased flow of statistics. It has not fulfilled its intentions of stabilizing cocoa prices, largely because prices have always been above the negotiated ceiling. The agreement has set up a substantial fund for the purchase of buffer stocks—useful only if prices ever descend to the floor level. This does not seem a likely prospect, since cocoa prices are far above the agreement ceiling of 55 cents per pound. Even though the ceiling price will probably be negotiated upward in September to a level of approximately 80 cents, cocoa prices are not likely to descend to this range in the next 15 months. The International Cocoa Agreement—to which the United States is not a party—will continue to be ineffective in defending consumer interests. (Confidential)

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Notes

USSR: Grain Purchases Mount

Recent purchases of Canadian and Australian wheat and a scheduled repayment in kind of a wheat loan to India could bring total Soviet grain acquisitions so far this year to 14 million tons. This is a large amount considering that Soviet grain prospects appear to be excellent for the second year in a row. However, with world grain prices low, the USSR can buy and store extra grain as a hedge against future crop failures.

During last week's visit to Canada by the Soviet Chairman of Eksportkhleb, Moscow bought 1.7 million tons of spring and durum wheat, reportedly for delivery in first half 1978. Last Monday, the Australian Wheat Board sold 450,000 tons of wheat to the Soviets for delivery during January to November 1978.

Market sources still contend that in June Moscow bought 6 million to 10 million tons of optional origin wheat and corn, most of which will come from the United States. These amounts have not appeared in USDA's weekly tabulation of grain export sales. Although US grain companies are required to report by law, their foreign affiliates are not obligated to do so if the US companies are not involved.

With negotiations still to be completed, India probably will export 1.6 million tons of hard and soft wheat to the USSR, beginning this October. The wheat is in repayment of Soviet wheat sent to India in 1973. India has had two good harvests and foodgrain stocks are at unprecedented levels.

The USSR will use most of the imports for producing higher quality bread, improving livestock herds, and rebuilding depleted grain stocks. Some of the Canadian grain will go to Cuba in the form of wheat and flour, and perhaps as much as 1 million tons of the Indian and Australian grain will go to North Korea and Vietnam. An average of 3 million to 4 million tons of Soviet grain normally is shipped to Eastern Europe each year. (Confidential)

UNCTAD Sugar Conference To Reconvene

The UN Sugar Conference will be reconvened this September, as the result of last week's London meeting of 20 leading sugar importing and exporting countries. Chances for reaching a new sugar agreement now appear much improved although several sticky issues remain to be negotiated.

The London talks led to agreement in principle on stocks and stock financing, the major stumbling blocks in earlier negotiations. Exporters have agreed to accept reserve stocks of at least 2.5 million tons with the exact level still to be negotiated.

Despite the progress achieved at the meeting, the issues of minimum prices, special trade arrangements, quota allocation among exporters, and access to developed country markets remain to be resolved. Minimum prices in a new agreement will probably fall in the range of 10 to 13 cents per pound, based on last week's consensus. The current world price for sugar is about eight cents a pound. The trade arrangement issue may prove to be the most difficult; it centers largely on Cuba's exports to other Communist countries, an issue on which Havana has previously been uncooperative. (Cuba exports sugar to the USSR, Eastern Europe, and China under a mixture of barter and hard-currency arrangements, with the Communist countries generally free to reexport the sugar on world markets.) However, the Cuban position on other matters at the London talks was surprisingly constructive. The position taken by the United States, which imports about one-fourth of the sugar moving in the free world market, will be critical to results in the September conference. (Unclassified)

Publication of Interest*

The Impact of the 200-Mile Boundary Claims on the Soviet and Japanese Fishing Industries (ER 77-10437, July 1977, Secret)

This publication analyzes the effect of the spread of 200-mile fishing zones on the Soviet and Japanese fishing industries. It discusses the impact on domestic consumption and foreign trade and alternative ways of making up expected losses.

*Copies of this publication may be ordered by calling [redacted]

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